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Because Plan B's assets are exhausted in a higher priority category than Plan A's assets, Plan B is the lower funded plan. A schedule will, therefore, be inserted in Priority Category 4 of the plan as merged after

providing 10% of the benefits provided in category 4, i.e. the ratio of \$5,000 assets in Plan B allocated to category 4 to the \$50,000 liability in category 4. The schedule would be constructed as follows:

EE	(1)—Benefits on a termination basis before merger	(2)—Benefits provided from priority categories higher than Category 4	(3)—10% of benefits provided in priority Category 4	(4)—Benefits provided before schedule (2) + (3)	(5)—Schedule of benefits (1) - (4)
1	\$12,000	\$10,000	\$200	\$10,200	\$1,800
2	5,315	.....	400	400	4,915
3	1,753	.....	.....	.....	1,753
4	15,000	15,000	.....	15,000	.....
5	500	.....	500	500	.....

Example (2). The facts are the same as in Example (1). The plan, however, terminates one year later. Furthermore, no employee has accrued additional benefits during the year except that the \$2,000 benefit for EE₁,

that was originally in category 4 is now in category 3. The assets would be allocated to the priority categories to the extent that there are assets to cover the following benefits.

Priority termination category	EE ₁	EE ₂	EE ₃	EE ₄	EE ₅
3	\$12,000	.....	.....	\$15,000	.....
10% of 4	\$400	.....	.....	\$500
Schedule of benefits included in balance of Category 4	3,600	.....	.....	.....
Schedule of benefits included in Category 5	1,315	\$1,753	.....	.....
Schedule of benefits included in Category 6
Balance of Category 4 not included in schedule	4,500
Balance of Category 5 not included in schedule	1,685	2,247	.....	8,000
Balance of Category 6 not included in schedule	1,000	.....	.....

(l) *Merger of defined benefit and defined contribution plan.* In the case of a merger of a defined benefit plan with a defined contribution plan, one of the plans before the merger should be converted into the other type of plan (i.e., the defined benefit converted into a defined contribution or the defined contribution converted into a defined benefit) and either paragraph (d) or paragraphs (e) through (j) of this section, whichever is appropriate, should be applied.

(m) *Spinoff of a defined contribution plan.* In the case of a spinoff of a defined contribution plan, the requirements of section 414(l) will be satisfied if after the spinoff—

(1) The sum of the account balances for each of the participants in the resulting plans equals the account balance of the participant in the plan before the spinoff, and

(2) The assets in each of the plans immediately after the spinoff equals the sum of the account balances for all participants in that plan.

(n) *Spinoff of a defined benefit plan—*
(1) *General rule.* In the case of a spinoff of a defined benefit plan, the requirements of section 414(l) will be satisfied if—

(i) All of the accrued benefits of each participant are allocated to only one of the spun off plans, and

(ii) The value of the assets allocated to each of the spun off plans is not less than the sum of the present value of the benefits on a termination basis in the plan before the spin off for all participants in that spun off plan.

(2) *De minimis rule.* In the case of a spin off the requirements of section 414(l) will be deemed to be satisfied if the value of the assets spun off—

(i) Equals the present value of the accrued benefits spun off (whether or not vested), and

(ii) In conjunction with other assets spun off during the plan year in which the spinoff occurs in accordance with this subparagraph, is less than 3 percent of the assets as of at least one day in that year.

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Spinoffs occurring in previous or subsequent plan years are ignored if they are not part of a single spinoff designed to occur in steps over more than one plan year.

(3) *Special temporary rule.* In the case of a defined benefit plan maintained for different groups of employees, which is a single plan (as defined in paragraph (b)(1) of this section) and under which there has been separate accounting of assets for each group, a spinoff of the plan on or before July 1, 1978, into a separate plan for each group will be deemed to satisfy section 414 (1) if—

(i) All the liabilities with respect to each group of employees are allocated to a separate plan for that group of employees, and

(ii) The assets that are separately accounted for with respect to each group of employees are allocated to the separate plan for that group of employees. For purposes of this subparagraph, a separate accounting of assets will not be considered to have occurred to the extent that the assets allocated to each single plan are determined by an historical re-creation of benefits, contributions, investment gains, etc.

(c) *Transfers of assets or liabilities.* Any transfer of assets or liabilities will for purposes of section 414 (1) be considered as a combination of separate mergers and spinoffs using the rules of paragraphs (d), (e) through (j), (l), (m), or (n) of this section, whichever is appropriate. Thus, for example, if in accordance with the transfer of one or more employees, a block of assets and liabilities are transferred from Plan A to Plan B, each of which is a defined benefit plan, the transaction will be considered as a spinoff from Plan A and a merger of one of the spinoff plans with Plan B. The spinoff and merger described in the previous sentence would be subject to the requirements of paragraphs (n) and (e) through (j) of this section respectively.

[T.D. 7638, 44 FR 48195, Aug. 17, 1979]

§ 1.414(q)-1 Highly compensated employee.

Q&A-1—Q&A-8: [Reserved]. See § 1.414(q)-1T, Q&A-1 through Q&A-8 for further guidance.

Q-9: How is the top-paid group determined?

A-9: (a) [Reserved]. See § 1.414(q)-1T, Q&A-9(a) for further guidance.

(b) *Number of employees in the top-paid group—(1) Exclusions.* The number of employees who are in the top-paid group for a year is equal to 20 percent of the total number of active employees of the employer for such year. However, solely for purposes of determining the total number of active employees in the top-paid group for a year, the employees described in § 1.414(q)-1T, A-9(b)(1) (i), (ii) and (iii)(B) are disregarded. Paragraph (g) of this A-9 provides rules for determining those employees who are excluded for purposes of applying section 414(r)(2)(A), relating to the 50-employee requirement applicable to a qualified separate line of business.

(i)-(iii) [Reserved]. See § 1.414(q)-1T, Q&A-9(b)(1) (i) through (iii) for further guidance.

(2) *Alternative exclusion provisions—(i)-(ii)* [Reserved]. See § 1.414(q)-1T, Q&A-9(b)(2) (i) and (ii) for further guidance.

(iii) *Method of election.* The elections in this paragraph (b)(2) must be provided for in all plans of the employer and must be uniform and consistent with respect to all situations in which the section 414(q) definition is applicable to the employer. Thus, with respect to all plan years beginning in the same calendar year, the employer must apply the test uniformly for purposes of determining its top-paid group with respect to all its qualified plans and employee benefit plans. If either election is changed during the determination year, no recalculation of the look-back year based on the new election is required, provided the change in election does not result in discrimination in operation.

(c)-(f) [Reserved]. See § 1.414(q)-1T, Q&A-9 (c) through (f) for further guidance.

(g) *Excluded employees under section 414(r)(2)(A)—(1) In general.* This paragraph (g) provides the rules for determining which employees are excluded employees for purposes of applying section 414(r)(2)(A), relating to the 50-employee requirement applicable to a qualified separate line of business.

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(2) *Excluded employees*—(i) *Age and service exclusion.* All employees are excluded who are described in § 1.414(q)-1T, A-9(b)(1)(i) (relating to exclusions based on age or service). For this purpose, the rules in § 1.414(q)-1T, A-9 (e) and (f) (relating respectively to the 17½-hour rule and the 6-month rule) apply. However, the election in § 1.414(q)-1T, A-9(b)(2)(i) (permitting the employer to elect reduced minimum age or service requirements) does not apply.

(ii) *Nonresident alien exclusion.* All employees are excluded who are described in § 1.414(q)-1T, A-9(b)(1)(ii) (relating to the exclusion of nonresident aliens with no U.S.- source income from the employer).

(iii) *Inclusion of employees covered under a collective bargaining agreement.* All employees are included who are described in § 1.414(q)-1T, A-9(b)(1)(iii)(A) (relating to employees covered under a collective bargaining agreement) and who are not otherwise described in paragraph (g)(2) (i) or (ii) of this A-9. For this purpose, the exclusion in § 1.414(q)-1T, A-9(b)(1)(iii)(B) and the related election in § 1.414(q)-1T, A-9(b)(2)(ii) do not apply.

(3) *Applicable period.* The determination of which employees are excluded employees is made on the basis of the testing year specified in the regulations under section 414(r) and not on the basis of the determination year or the look-back year under section 414(q).

(h) *Effective date.* The provisions of this A-9 apply to plan years and testing years beginning on or after January 1, 1994.

Q&A-10 through Q&A-15: [Reserved]. See § 1.414(q)-1T, Q&A-10 through Q&A-15 for further guidance.

[T.D. 8548, 59 FR 32915, June 27, 1994]

§ 1.414(q)-1T Highly compensated employee (temporary).

The following questions and answers relate to the definition of “highly compensated employee” provided in section 414(q). The definitions and rules provided in these questions and answers are provided solely for purposes of determining the group of highly compensated employees.

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Q-1: To what employee benefit plans and statutory provisions is the definition of highly compensated employee contained in section 414(q) applicable?

A-1: (a) *In general.* This definition is applicable to statutory provisions that incorporate the definition by reference.

(b) *Qualified retirement plans*—(1) *In general.* Generally, this definition is incorporated in many of the nondiscrimination requirements applicable to pension, profit-sharing, and stock bonus plans qualified under section 401(a). See, e.g., the nondiscrimination provisions of sections 401(a) (4) and (5), 401(k)(3), 401(l), 401(m), 406(b), 407(b), 408(k), 410(b) and 411(d)(1). The definition is also incorporated by certain other provisions with respect to such plans, including the aggregation rules of section 414(m) and section 4975 (tax on prohibited transactions).

(2) *Not applicable where not incorporated by reference.* This definition is not applicable to qualified plan provisions that do not incorporate it. See, e.g., section 415 (limitations on contributions and benefits), with the exception of section 415(c)(3)(C) and 415(c)(6) (special rules for permanent and total disability and employee stock ownership plans respectively).

(c) *Other employee benefit plans or arrangements.* This definition is incorporated by various sections relating to employee benefit provisions. *See, e.g.,* section 89 (certain other employee benefit plans), section 106 (accident and health plans), 117(d) (qualified tuition reduction), section 125 (cafeteria plans), section 129 (dependent care assistance programs), section 132 (certain fringe benefits), section 274 (certain entertainment, etc. expenses), section 423(b) (employee stock purchase plan provisions), section 501(c) (17) and (18) (certain exempt trusts providing benefits to employees), and section 505 (certain exempt organizations or trusts providing benefits to individuals). See the respective sections for the applicable effective dates.

(d) *ERISA.* This definition is not determinative with respect to any provisions of Title I of the Employee Retirement Income Security Act of 1974 (ERISA), unless it is explicitly incorporated by reference (e.g., section 408(b)(1)(B)).

Q-2: Who is a highly compensated employee?

A-2: The group of employees (including former employees) who are highly compensated employees consists of both highly compensated active employees (see A-3 of this § 1.414(q)-1T) and highly compensated former employees (see A-4 of this § 1.414(q)-1T). In many circumstances, highly compensated active employees and highly compensated former employees are considered separately in applying the provisions for which the definition of highly compensated employees in section 414(q) is applicable. Specific rules with respect to the treatment of highly compensated active employees and highly compensated former employees will be provided in the regulations with respect to the sections to which the definition of highly compensated employees is applicable.

Q-3: Who is a highly compensated active employee?

A-3: (a) *General rule.* For purposes of the year for which the determination is being made (the determination year), a highly compensated active employee is any employee who, with respect to the employer, performs services during the determination year and is described in

any one or more of the following groups applicable with respect to the look-back year calculation and/or determination year calculation for such determination year. See A-14 for rules relating to the periods for which the look-back year calculation and determination year calculation are to be made.

(1) *Look-back year calculation.*

(i) *5-percent owner.* The employee is a 5-percent owner at any time during the look-back year (i.e., generally, the 12-month period immediately preceding the determination year; see A-14. (See A-8 of this § 1.414(q)-1T.)

(ii) *Compensation above \$75,000.* The employee receives compensation in excess of \$75,000 during the look-back year.

(iii) *Compensation above \$50,000 and top-paid group.* The employee receives compensation in excess of \$50,000 during the look-back year and is a member of the top-paid group for the look-back year. (See A-9 of this § 1.414(q)-1T.)

(iv) *Officer.* The employee is an “includible officer” during the look-back year. (See A-10 of this § 1.414(q)-1T.)

(2) *Determination year calculation.*

(i) *5-percent owner.* The employee is a 5-percent owner at any time during the determination year. (See A-8 of this § 1.414(q)-1T.)

(ii) *Top-100 employees.* The employee is both (A) described in paragraph (a)(1)(i), (ii) and/or (iv) of this A-3, when such paragraphs are modified to substitute the determination year for the look-back year, and (B) one of the 100 employees who receive the most compensation from the employer during the determination year.

(b) *Rounding and tie-breaking rules.* In making the look-back year and determination year calculations for a determination year, it may be necessary for an employer to adopt a rule for rounding calculations (e.g., in determining the number of employees in the top-paid group). In addition, it may be necessary to adopt a rule breaking ties among two or more employees (e.g., in identifying those particular employees who are in the top-paid group or who are among the 100 most highly compensated employees). In such cases, the employer may adopt any rounding or tie-breaking rules it desires, so long as

such rules are reasonable, nondiscriminatory, and uniformly and consistently applied.

(c) *Adjustments to dollar thresholds*—(1) *Indexing of dollar thresholds.* The dollar amounts in paragraph (a)(1) (i) and (ii) of this A-3 are indexed at the same time and in the same manner as the section 415(b)(1)(A) dollar limitation for defined benefit plans.

(2) *Applicable dollar threshold.* The applicable dollar amount for a particular determination year or look-back year is the dollar amount for the calendar year in which such determination year or look-back year begins. Thus, the dollar amount for purposes of determining the highly compensated active employees for a particular look-back year is based on the calendar year in which such look-back year begins, not the calendar year in which the look-back year ends or in which the determination year with respect to such look-back year begins.

(d) *Employees described in more than one group.* An individual who is a highly compensated active employee for a determination year, by reason of being described in one group in paragraph (a) of this A-3, under either the look-back year calculation or the determination year calculation, is not disregarded in determining whether another individual is a highly compensated active

employee by reason of being described in another group under paragraph (a). For example, an individual who is a highly compensated active employee for a determination year, by reason of being a 5-percent owner during such year, who receives compensation in excess of \$50,000 during both the look-back year and the determination year, is taken into account in determining the group of employees who are highly compensated active employees for such determination year by reason of receiving more than \$50,000, and being in the top-paid group under either or both the look-back year calculation or determination year calculation for such determination year.

(e) *Examples.* The following examples, in which the determination year and look-back year are the calendar year, are illustrative of the rules in paragraph (a) of this A-3. For purposes of these examples, the threshold dollar amounts in paragraph (a)(1) (ii) and (iii) of this A-3 are not increased pursuant to paragraph (c) of this A-3.

Example (1). Employee A, who is not at any time a 5-percent owner, an officer, or a member of the top-100 within the meaning of paragraph (a)(1) (i), or (iv), or (a)(2) (i) or (ii), but who was a member of the top-paid group for each year, is included in or excluded from the highly compensated groups as specified below for the following years:

Year	Compensation	Status	Comments
1986	\$45,000	N/A	Although prior to 414(q) effective date, 1986 constitutes the look-back year for purposes of determining the highly compensated group for the 1987 determination year.
1987	80,000	Excl	Excluded because A was not an employee described in paragraph (a)(1) (ii) or (iii) of this A-3 for the look-back year (1986).
1988	80,000	Incl	Included because A was an employee described in paragraph (a)(1) (ii) or (iii) of this A-3 for the look-back year (1987).
1989	45,000	Incl	Included because A was an employee described in paragraph (a)(1) (ii) or (iii) of this A-3 for the look-back year (1988).
1990	45,000	Excl	Excluded because A was not an employee described in paragraph (a)(1) (ii) or (iii) of this A-3 for the look-back year (1989).

Example (2). Assuming the same facts as those given in *Example (1)*, except that A is a member of the top-100 employees within the

meaning of paragraph (a)(2)(ii) of this A-3 for the 1987 year and 1990 year, the results are as follows:

Year	Compensation	Status	Comments
1986	\$45,000	N/A	Although prior to 414(q) effective date, 1986 constitutes the look-back year for purposes of determining the highly compensated group for the 1987 determination year.
1987	80,000	Incl	Included because A was an employee described in paragraph (a)(1)(ii) or (iii) of this A-3 for the determination year (1987) and was described in paragraph (a)(2)(ii) of this A-3 in that year.